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Public Administration, Human Resources
and Social Development Division

REPORT ON A WORKSHOP FOR ZAMBIA GOVERNMENT SELECTED FINANCIAL MANAGEMENT OFFICIALS ON MANAGEMENT OF PUBLIC EXPENDITURE PLANNING:

PUBLIC FINANCE
Lusaka (Zambia) 1-12 April 1991

May 1991

Date and Venue

1. A national workshop on public finance for selected Zambia government financial management officials was held in collaboration with the Zambia National Institute of Public Administration (NIPA) in Lusaka, (Zambia) from 1 through 12 April, 1991. The workshop is within the programme of assisting member states' governments on management of public expenditure planning.

Objective of the Workshop

2. The aim of the workshop was to expose the participants to the nature and scope of public finance for their better understanding of the macro-economic framework which is needed for the management of public expenditure planning.

Attendance

3. Ten senior Zambia government officials attended the workshop (see Annex I for list of participants).

Topics Discussed

4. The following topics were discussed:

- The nature of public finance.
- The significance of public expenditure.
- Sources of public income.
- Objectives and principles of taxation.
- Government borrowing: public debt.
- Monetary policy.
- National income analysis.
- Management of public debt.
- The role of fiscal policy.

5. In addition to the discussion of the above topics, the participants discussed in groups the following themes:-

- Significance of Zambia government expenditure composition and pattern;

- Zambia government tax structure.
  (See Annex II for the daily programme of work).

Summary of Topics Discussed

I. THE NATURE OF PUBLIC FINANCE

Meaning of Pubkic Finance [1]

6. Public finance deals with the finances of the public as an organized group of government. The finances of government include the raising and disbursement of government funds. Public finance is concerned with the operation of the fisc or public treasury. Hence, to the degree that it is a science, it is the fiscal science, its policies are fiscal policies, its problems are fiscal problems.

7. Public finance is part of the general study of economics and possesses just as economics a positive and normative side although these two sides have their special characteristics due to the field of operations of the art. One part of positive public finance is concerned with the description and analysis of the machinery of public expenditure and of the assessment and collection of revenue. A knowledge of the parts of this machinery is necessary to understand its working for example, the way in which a particular piece of fiscal policy - a new type of expenditure or a tax change - will affect the economy.

8. A second and more fundamental part of positive public finance consists in the analysis of the actual process by which taxes (or subsidies and transfers which are merely negative taxes) of particular types work through an economic system. This Analysis is necessary to discover the economic consequences of fiscal changes. For convenience, this analysis is referred to as the theory of Taxation or Tax Incidence, although it is also concerned with certain types of expenditures.

9. Normative public finance is concerned with judgements on particular types of economic policy, those which are, or may be implemented by, programmes of expenditure or of revenue collection; the ends which are sought in this manner cannot, however, differ in any way from those sought by other types of economic policy and may more conveniently be implemented by different means than by public finance.

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[1] Philip E. Taylor: The Economics of Public finance, The MacMillan Company, New York, 1965.

Ursula K. Hicks: Public finance, James Nisbet and Co. Ltd., Cambridge at the University Press, 1961.

Government Finance and Business Finance

10. What similarities and what differences are to be found in government fiscal operations as compared to monetary operations of private business? It has sometimes been said that government and business are fundamentally dissimilar in that government adjusts its tax income to its desired scale of expenditure, whereas business must adjust its expenditure to its income. The distinction mentioned is in some cases not real. Both government and business (and consumers) resort to borrowing when current revenues are inadequate to accomplish what they wish to do. Businesses often increase income by first increasing expenditure and loans fill the gap. Government borrows in anticipation of tax receipts and borrows to spend to increase national income; from which flows increased tax receipts.

11. There are, however, differences between government and business with respect to their financial operations. Business determines the advisability of expenditure almost exclusively in terms of its capacity to produce revenue for the business. Government on the hand, spends to promote general welfare, where no revenue is anticipated. The objectives and motives of government in making expenditures are thus different from those of private business. Another difference between government and private business lies in the different degrees of their coercive authority. Tax measures are coercive.

The Principle of Maximum Social Advantage

12. One fundamental principle which lies at the root of public finance is called "The Principle of Maximum Social Advantage". All the operations of public finance resolve themselves into a series of transfers of purchasing power, or of variations in total purchasing power, and of consequential changes in the use of economic resources. These transfers are made, by taxation or otherwise, from certain individuals to public authorities and back again from these authorities, by way of public expenditure, to other individuals some of these beneficiaries of public expenditure receive not only power in the form of money but specific goods or services, such as education or medical treatment.

13. As a result of all these operations of public finance, changes take place in the amount and in the nature of the wealth which is produced, and in the distribution of that wealth among individuals and classes. Are these changes in their aggregate effects socially advantageous? If so, the operations are justified; if not, not. The best system of public finance is that which secures the maximum social advantage from the operations which it conducts. This principle is obvious, simple and far reaching, though its practical application is often very difficult.

14. To apply this principle of maximum social advantage, one needs to have before him certain tests of social advantage. The first is the need to preserve the community. The others are economic tests of social advantage. Improvements in production and improvements in the distribution of what is produced. In carrying out these tests account should be taken of all the proposal which is under discussion; strike a balance of probable gain and loss to the community; compare this balance with that of alternative proposals and act upon the results of this comparison.

II. THE SIGNIFICANCE OF PUBLIC EXPENDITURE

Nature of Public Expenditure

15. Public expenditures of any country depend on the duties or functions to be carried out by the government of that country. According to Adam Smith in his book the Wealth of Nations published in 1776 the "duties of the sovereign" fall into three classes. The first duty of the State is that of "defending the society from the violence and injustice of other independent societies. The second is that of securing internal justice between citizens. The third duty as defined by Smith is "erecting and maintaining those public institutions .... and works which though they may be in the highest degree advantageous to a great society, could never repay the expense to any individual". He considers those for facilitating the commerce of the society and for promoting the instruction of the people. Nowadays, Smith's third duty would be described as expenditure for economic and social ends.

Growth and Pattern of Public Expnditure

16. The earliest theory advanced regarding the growth of public expenditure is that of Adolph Wagner who stated, in what has come to be known as the "law of increasing state activities", that the share of the public sector in the economy will rise as economic growth proceeds. There has been, however, variations of this law since researchers have interpreted the Wagner's law in their own way. These are:

(a) that government expenditure must increase at an even faster rate than output,

(b) that in growing economies the share of public consumption expenditures in the national income increases,

(c) that as a nation experiences economic development and growth, and increase must occur in the activities of the public sector and that the ratio of increase, when converted into expenditure terms would exceed the rate of increase in output per capita,

(d) that there would be a rising share of the public sector or ratio of public expenditure to GNP in the context of the development of a country from low to high per capita income.

While attempts continue to be made to explain the factors that determine public expenditures, the question for consideration, however, is whether there can be a law that will explain this phenomenon? If such a law is to be found, needless to add, the planning of public expenditure would be made that much easier. It will readily be admitted that no such laws, with the precision found in physical sciences can be evolved for social sciences in view of the immense complexity and unpredictability of social forces and consequently social events.

Factors Affecting the Pattern of Government Expenditure

17. No specific guidelines can be laid down to show the levels and composition of public expenditure. These factors enumerated below are not exhaustive nor is the order indicative of relative importance.

(i) Environmental factors: geography, history, constitutional framework.

(ii) Technological factors: population growth and age structure, population density and distribution, production (and consumption) technology.

(iii) Economic factors: grwoth of national income, distribution of income level and rate of growth of per capita income, rate of price change productivity changes.

(iv) Political factors: ideology, character of political institutions, tax tolerance, occurrence of crises, attitudes to centralization.

(v) Administrative factors nature of budgetary process nature of bureaucracy, habit.

Policy Objectives

18. The overall objectives of government expenditure and the specific instruments chosen for the achievement of objectives are shown in the table below.

Table: Public Expenditure Objectives and Instruments

Objectives	Determinants Objectivcs	Exepnditure Instruments
Provision for social wants	Socio-political approaches	Provision of public goods and services (consumption and expenditures): investment in production of goods, and outlays on social, general, and economic services.
Distribution of Income		
(1) Among people	Socio-political approaches	Transfer payments; direct and indirect subsidies; provision of goods and services to specific income groups of the community.
(2) Among regions	Socio-political approaches	Investment in less developed regions. Greater subventions and grants.
Stabilization or demand management	Economic factors	Reductions or increases in government expenditures: changes in the composition of expenditures and methods of financing the budget deficits.
Optimal growth	Socio-economic imperatives	Investment expenditures: other expenditures on the provision of infrastructure.
Employment	Socio-economic imperatives	Investment in labor-intenstive industries: subsidies and related fiscal incentives; expenditures on technical and vocational education.

III. SOURCES OF PUBLIC INCOME

19. The income of a public authority may be defined either in a borad of a narrow sense. In the broad sense it includes all "incomings" or "receipts", in the narrow sense only those receipts which are included in the ordinary conception of revenue. To avoid ambiguity, the terms "public receipts" and "public revenue" may be used to denote public income in its broad and in its narrow sense respectively. The chief elements included in the conception of public receipts but excluded from that of public revenue, are receipts from public borrowing and from the sale of public assets such as war stores.

20. Public income in derived from taxes, prices, penalties, receipts, fees or payments, voluntary gifts, loans etc.

21. Taxes: A tax is a compulsory charge imposed by a public authority without reference to a particular benefit received by the tax payer. A tax is distinguished from a price, which is (generally) a voluntary payment for a good or service and from a license or fee which may be compulsory or voluntary but is related to the enjoyment of a certain benefit or privilege extended by government.

22. Prices: An important source of public income are prices charged by a public authority for specific services and commodities supplied by it, including the prices charged for the use of public property. Generally, these prices are paid voluntarily by private persons, who enter into contracts, express or implied with public authorities, whereas taxes are paid compulsorily.

23. The boundary lines between the various kinds of public income are not in most cases clear cut but one kind shades gradually into another. Thus taxes shade gradually into prices since the services rendered by public authorities to taxpayers often stand in a some what indefinite relation to the payments made by the latter. Again the definition given above for a tax would cover penalties for offences.

24. The distinction between taxes and penalties is one of motive; a public authority imposes taxes mainly to obtain revenue and enacts penalities mainly to deter from certain acts. If motorists were fined US$1 for every infraction of the speed limit, and the money were collected periodically, such fines might be regarded as a tax on high speed, comparable to a tax on petrol. But if, at each successive offence by the same motorists, the fines were increased, and the offender finally put in prison or deprived of his license to drive, so that no more fines were obtainable from him, those already collected would clearly be in the nature of penalties and not taxes.

IV. OBJECTIVES AND PRINCIPLES OF TAXATION

25. The primary purpose of taxation is to divert control of economic resources from taxpayers to the government for its direct utilization or transfer to others. This is usually accomplished for forcing taxpayers to surrender purchasing-power, money, to the government. Taxes may also be used to regulate economic activity.

26. Taxation is necessary because it would not be possible or desirable to obtain all resources needed for government programmes from prices, licences or fees. Services such as national defence and general public administration could not be sold to individuals. If the services are provided the benefits are generally available and one person's enjoyment of them does not diminish the benefits available to others.

Tax Design Principles

27. Taxes should conform to certain standards or criteria. These may be summarized in the following principles.

(a) Equity: Taxes should be allocated in a fair and reasonable way.

(b) Economic Efficiency: Taxes should not unnecessarily hinder the attainment of economic objectives including full production, growth and stability. Taxes may indeed be used to advance these objectives.

(c) Administrative Feasibility: Taxes should be capable of administration at reasonable cost and should not impose excessive burdens of compliance on taxpayers.

28. Inconsistences or conflicts between tax principles may exist. Preoccupation with equity may lead to the adoption of measures that harm economic efficiency, whereas attempts to promote economic objectives may result in tax provisions causing unfair benefits or burdens. Taxes which appear to meet high standards of equity and economic efficiency may be so complex that they are costly or even impossible, to administer whereas the simplest taxes can take little account of equity and economic efficiency. Tradeoffs or comprises are necessary to allow the principles to be followed to the greatest extent that circumstances allow.

Equity

29. Equity requires that taxes be imposed according to general and objective rules that are recognized as reasonable and just. The meaning of equity remains nebulous. Although the twin principles of equal treatment for people in like circumstances and unequal treatment in unlike cases are recognized, attempts to pin these statements down have not been successful. Partly, because unlike circumstances can take many different forms (income, wealth etc.)

30. The traditional interpretation of equity is that taxes should be paid by those who benefit from the governments protection and services. This principle offers a broad justification for jurisdiction to tax. The benefit principle requires that government should tax only persons who are residents or citizens and who may receive some benefits from it.

31. Another principle which flows from equity is the ability-to-pay principle. It calls for equal taxation of persons with equal abilities to pay (often termed "horizontal equity). Ability to pay is related to economic capacity as measured by income, wealth or consumption.

32. The ability-to-pay principle also calls for reasonable difference in taxation of persons with unequal abilities to pay (often termed "vertical equity"). This principle gives rise to progressive taxation.

Economic Efficiency

33. Taxation can damage economic efficiency by imparing productive capacity, reducing incentives and distorting the allocation of resources. On the other hand, carefully designed tax provisions can improve efficiency by encouraging desirable activities and assisting in the assignment of social costs.

34. Taxation may impair productive capacity if it infringes on the minimum consumption necessary to maintain the health and energy of works.

35. The influence of taxation on economic incentives should be carefully considered in designing a tax system. Taxes have two kinds of effect on incentives:

(a) Substitution effect and an income effect. The substitution effect is the reduction in the rate of reward obtained by working, saving, investing, making innovations and carrying on other productive activities. The substitution effect is more severe for progressive taxes than for proportional or regressive taxes. The income effect is the reduction of income caused by the tax payment. Often the income effect stimulates taxpayer to work more in an effort to maintain a customary standard of living or to attain a desired standard.

Administrative Efficiency

36. Administrative efficiency implies the minimization of the amount of real resources needed to administer any type of tax or expenditure. Simplicity is a great administrative advantage. Indirect taxes on production or sales are much simpler than direct taxes on income and wealth.

37. For a tax to be readily acceptable from the administrative angle, there are certain general principles to be followed. There are a readily identifiable body of taxpayers, a simple structure of tax rates, a minimum amount of changing of rates and regulations and convenience to taxpayers.

Classification of Taxes

38. The commonest distinction of taxes is between direct and indirect taxes. Direct tax is really paid by the person on whom it is legally imposed. While an indirect tax is imposed on one person but paid partly or wholly by another. Thus an indirect tax is conceived as one which can be shifted or passed on. An income tax is generally regarded as a direct tax while taxes on commodities and transactions are regarded as indirect.

Meaning of Incidence of Taxation

39. The problem of the incidence of a tax is commonly conceived as the problem of who pays it. More precisely the incidence is upon those who bear the direct money burden of the tax.

40. A distinction must be drawn between the direct and the indirect burden of the tax and also between the money burden and the real burden. The total direct money burden is equal to the total yield of the tax to the public treasury. To every US dollar of revenue raised there corresponds a dollar of direct money burden or incidence falling upon someone. To part with a dollar in payment of a tax means a greater sacrifice of economic welfare for a poor man than for a rich man. But that is a question not of the incidence, but of the direct real burden of the tax. Again when the price of sugar is raised by taxation, a family may have to eat less sugar and so make a sacrifice of economic welfare. But that is a question; not of the incidence, but of the indirect real burden of the tax.

41. Thus the incidence of a tax on a commodity collected from the seller is wholly on the buyer, if as a direct result of the tax the price rises by at least the full amount of the tax; wholly on the seller if the price does not rise at all, partly on the buyer and partly on the seller if the price rises by an amount less than the full amount of the tax. It is commonly assumed that income tax is a direct tax. The extent to which income taxpayers can shift the incidence of the tax is, no doubt, so small especially in the short run. Regarding taxes on commodities or services, two general propositions may be laid down. The first is that other things being equal the more elastic the demand for the object of taxation the more will the incidence of tax be upon the seller. And the second is that, other things being equal, the more elastic the supply of the object of taxation, the more will the incidence of the tax be upon the buyer.

Development of Tax Systems

(i) Tax Structure

42. Several authors have addressed themselves to the relationship between structure of taxation and the level of economic development of a country. Tax structure implies the types of taxes used and the reliance on each type of tax in a tax system. Authors as Musgrave and Hinrichs[1/] have pointed that the structure of taxation changes as economic development of a country changes. In an early stage of development of a country, while a tax system will comprise taxes such as poll tax, etc., yet this type of tax gives way to indirect taxes, generally indirect taxes such as foreign trade taxes, (import and export taxes) in particular. As a country becomes more developed and either naturally or with an assistance from a conscious policy of import substitution, local manufacturing comes into existence, the taxes on foreign trade begin to decline in importance and are often replaced by internal indirect taxes such as excise duties.

V. GOVERNMENT BORROWING: PUBLIC DEBT

43. One source of public income is borrowing. The proceeds of such public borrowing form part of public receipts. On the other hand, the payment of interest on, and the repayment of the principal of the public debts thus created form part of public expenditure.

Classification of Public Debts

44. Government or public debt arises out of borrowing. Borrowing is resorted to by governments in order to provide funds for financing a current budget deficit. In recent years, a major part of African governments' financial resources needed for development has come from government borrowing, internally and externally. This situation arose because African countries have had inadequate financial resources but large financial requirements.

45. Public loans may be classified in various ways. In the first place, a loan may be either voluntary or compulsory. In a voluntary loan, lenders are free to subscribe as much or as little as they please while as for a compulsory loan, lenders are forced to subscribe. In the second place, a public loan may be either internal or external. A loan is internal, if subscribed by persons or institutions within the area controlled by the public authority which raises the loan; external, if subscribed by governments, or institutions outside this area. In the third place, a public loan may be for a long or for a short term. This is a distinction of degree.

1/ See example: Harley H. Hinrichs: A general theory of the tax structure change during economic development. (Cambridge: Harvard Law School, 1966).

Internal Loans

46. These involve transfers of wealth within the borrowing community which in this case is the same as the lending community. Internal loans consist of treasury bills and advances which the Treasury or the Ministry of Finance takes from time to time from the Central Bank or from government departments which have spare cash to invest. Such latter borrowings are known as ways and means advances. These two types of internal borrowings are known as floating debts. Ways and means advances provide the means of covering government current expenditure. These advances are in a class by themselves since they are entirely internal transactions and their terms are not revealed.

47. The other internal loans are short-term securities such as bonds and national savings certificates.

External Loans

48. External loans may include private and public and publicly guaranteed debt. These may also be of a medium and long term nature. An external loan involves first, a transfer of wealth from the lending to the borrowing country when the loan is made, and second, a transfer in the reverse direction, when interest is paid or principal repaid.

Burden of Public Debts

49. The burden of public debt may be the direct money burden, the direct real burden and the indirect burden.

(A) External Debt

(a) Direct Money Burden

50. During any given period, the direct money burden of an external debt is measured by the sum of money payments, for interest and repayment of principal, to external creditors.

(b) Direct Real Burden

51. The interest and repayment of principal gives rise to the loss of economic welfare to members of the debtor community. This loss of economic welfare is the direct real burden of external debt. If the direct money burden is given, the direct real burden will vary according to the proportions in which various members of the community contribute to the required money payments. These money payments are used by the external creditors which would otherwise have been at the disposal of nationals of the debtor country. The latter are, therefore, deprived of goods and services to this amount and the resulting direct real burden will depend on the way in which this deprivation is distributed. If creditor countries' demand for debtor countries' exports is inelastic, the debtor countries will pay by importing less from creditor countries unless they pay from their gold and foreign exchange currency reserves.

(c) Indirect Burden

52. The indirect burden of an external debt, whether money burden or real burden, arises from any check to production due first to the taxation required to meet the debt charges and second, to any economies in forms of public expenditure which would promote production.

(B) Internal Debt

53. In the case of internal debt, transactions are with debtors and creditors within the same country. Thus, all transactions connected with an internal debt resolve themselves into a series of transfers of wealth within the country. It follows, therefore, that there can never be any direct money, or direct money benefit, of an internal debt. For all the money payments cancel out. For instance, the ministry of finance or the Treasury makes certain payments, for interest on ways and means advances or repayment of the principal and these payments are received by the Central Bank who is the government creditor. Often, the Treasury and the Central Bank are the same government institutions.

54. An internal debt will involve a direct real burden or a direct real benefit to the nationals according to the nature of the series of transfers from taxpayers to public creditors. It will bring burden or benefit, according as the transfers, increase or decrease the inequality of incomes. There will be a direct real burden, if the proportion of taxation paid by the rich towards the cost of the debt service is smaller than the proportion of public securities held by them. there will be a direct real benefit if it is larger.

55. An internal debt is likely to involve an additional an indirect burden on the nationals. One reason for this is that the taxation required for the services of the debt may check production if it reduces the taxpayers' ability and desire to work and save. Another reason is that short sighted economies and undesirable social expenditure are likely to be made, when heavy taxation is required to meet debt charges. An external debt does the same.

Public Debt Management

56. When borrowing is over, debt management becomes important. Governments, in this respect, are faced with the question of minimizing the budgetary charge of the debt arising from the payment of interest on the debt and repayment of the principal. As far as external debt is concerned, a government's immediate interest is, of course, its own external liabilities which affect both the budget and foreign exchange reserves. Debt management is concerned with both external debt, (including private debt) and public debt (including internal debt) and its ultimate objective is to help government manage both foreign exchange availabilities and public finances.

VI. MONETARY POLICY[1/]

57. Monetary policy seeks to regulate the level of money, or more broadly liquidity, in an economy. In Western economies, the traditional concern about monetary policy relates to its impact on economic stabilization. From that perspective, the interest in money derives from its relationship with the level of spending in the economy and is fundamentally rooted in the use of money as a medium of exchange. The basic concept is that there is a stable demand for real money (nominal money less changes in the price level) by the public. Confronting this demand is a nominal supply of money which is, at least potentially, under control of monetary authorities. The public's spending behavior affects the price level, until the real supply of money is equated with the real demand.

Definition of Money

58. For purposes of policy and analysis, the definition of the money stock is empirically determined. There is a variety of monetary instruments which are acceptable as a means of payment, collectively termed liquidity, with varying degrees of substitutability among them. The question of which instruments are relevant for policy depends on the closeness of their links with spending. The narrowest definition of the money stock, commonly known as M1, is currency plus demand deposits held by the non-bank public. Who holds this money is an important aspect of the definition. Generally M1 includes money held by the enterprise sector but excludes the government sector, because government spending is less constrained by the availability of liquidity than spending by private agents and enterprises. Spending behavior by the non-bank public, on the other hand, is assumed to be affected by its liquidity.

60. The appropriate definition of the money stock thus depends on institutional characteristics of a society, but essentially those financial assets which are used and accepted in making payments are part of the money supply. Typically, in modern economies, money represents obligations of financial institutions, almost always banks, whose obligations are generally accepted as means of payment in the economy.

Monetary Policy Instruments

61. Instruments of monetary policy available to a government are interest rate policies, credit ceilings, reserve requirements, open market operations, refinancing and rediscounting facilities, selective credit policies, and finally - and importantly for an open economy - exchange rate policies. These instruments may be helpfully divided into those which directly influence the quantity of money and credit, and those which, in the first instance, affect the price and thereby the quantity of money and credit.

1/ The World Bank: Monetary Policy: Suman Bery, Chief, National Economic Management division, Economic Development Institute.

62. Interest rate policies are the one area where economic stabilization and what one might call developmental objectives of financial policy come together. An important objective of the development process is to facilitate intermediation between savers and investors, to detach savings from primary savers and make them available in financial form to the most efficient investors in the economy. Prerequisites of this process are, first, confidence in the financial system and, second, a return or yield on financial instruments in excess of the return on holding commodities which is represented by the rate of inflation. So, one policy rule that emerges from these considerations is that financial institutions should aim at offering investment yields that are positive in real terms (i.w., more than the rate of inflation). Quite apart from this, one way of shifting money demand from demand deposits to time deposits is to increase the interest rates on the latter. This sounds reasonable as far as savers are concerned. There is often concern that such increases in interest rates will reduce investment demand and thereby retard capital accumulation. This dilemma is more apparent than real, however, since the availability of financial savings in the economy will in fact be increased by a high interest rate and thereby more financing for investment would be provided through an appropriate interest rate policy. Charging a realistic price on capital would also give correct indications of its scarcity. A regime of positive real interest rates indicates to investors that capital is a scarce commodity and should be used carefully.

63. Credit ceilings and reserve requirements are alternative ways of achieving the same end, namely the management of the stock of credit and money. In an economy like the United States with a very decentralized private banking system, there has been comparatively little use of credit ceilings. Credit ceilings are sometimes used to restrict the volume of loans; alternatively they are used to influence the aggregate money supply. These different objectives reflect different views of monetary behavior. Some economists argue that the volume of credit directly affects spending in an economy; in this view, restrictions on the increase in outstanding credit over a given period becomes of interest to policy-makers. Loans, however, also represent assets acquired by banks, which are financed by generating deposits. If loans are restricted, the banks' ability to increase deposits is controlled and thereby the money supply is controlled.

64. Changes in reserve requirements alter the money supply by inducing changes in the level of deposits of the banking system. With a given stock of reserves, a change in the reserve requirements forces the banking system to adjust its deposits.

65. Even though these two sets of instruments operate to achieve the same ends, there is a fundamental distinction between a policy strategy primarily concerned with the volume of credit, and a policy strategy which is concerned with the money supply. If the concern is with the money supply, it is better to operate through the reserve requirements

which commercial banks are typically required to maintain at the central bank as a ratio of their deposits. A change in reserve requirements is preferred to the imposition of or a variation in credit ceilings because credit ceilings are often inefficient in implementation. Credit ceilings tend to penalize decisions at the margin; usually a credit ceiling will freeze the status quo and new and worthy borrowers are unable to get access to funds.

Open market operations

66. Similar changes in the money supply can be brought about by working directly on the level of reserves in the system, that is, without changing the reserve requirement. Typically, through what are called open market operations, the central bank buys or sells government securities in order to influence the level of reserves in the banking system. That, in turn, changes the level of deposits that banks are able to support and therefore the money stock.

67. The drawback of using reserve requirements to influence the money supply is essentially that reserve requirements reduce the loan-making potential of commercial banks; and to the extent the banking system is used to make allocative decisions.

68. Refinancing and rediscounting are virtually the same process. Rediscounting facilities mean that a portion of loans made by commercial banks can be exchanged directly for reserves at the central bank; in refinancing, the amount is made available by the central bank as a loan. Refinancing and rediscounting facilities provide an incentive to a commercial bank to make credit available in the chosen area in two ways, one, typically funds are made available at a price lower than what a bank may pay for deposits; and two, the access to reserves increases the bank's capacity to make more loans. The problem with these facilities is that they tend to be open-ended, and that means that the control over reserves is loosened. Unless there is some mechanism of open market operations offsetting the effect of refinancing facilities, the control over the money stock can be lost.

69. Selective credit policies are not really that directly related to the money stock. They are an attempt to influence the allocation of credit, given by the commercial banks to the public, among various users.

VII. NATIONAL ACCOUNTS

70. The national accounts of a country relate to:

(i) production
(ii) consumption
(iii) accumulation
(iv) external trade

71. Production

71. It relates to (a) commodities (goods and services normally intended for sale on the market at a price that covers their cost of production) whether these are produced in domestic activities or imported; (b) activities whether or not the main purpose of these activities is to produce commodities. The production activity consists of industries which produce commodities, the producers of government services, and the private services in the sense of domestic services and the producers of private non-profit services to households.

Consumption

72. This aggregate shows expenditures for the purposes of consumption by the private and public sectors of the economy that is expenditures by:

- private households and individuals,
- government departments and private non-profit institutions,
- direct expenditures abroad from imports.

73. Under consumption aggregate is shown income and outlay which are the current accounts of the institutional sectors such as non-financial enterprises, corporate and quasi-corporate, financial institutions etc.

Accumulation

74. This consists of:

- increase in stocks
- fixed capital formation
- financial claims
- capital finance

75. The capital formation accounts relate to expenditure on tangible assets other than land, mineral rights and the like. They will relate to such activities such as health, education and other government social services.

External Trade

76. This consists of:

- Current transactions: These show the rest of the world's incoming from the sale of commodity imports, direct expenditures abroad and receipts of distributed factor income and current transfers. The transactions will also show exports or the world's outgoing on the purchase of commodity exports.

- capital transactions with the rest of the world.

Use of the National Accounts

77. A series of national accounts are useful, indeed indispensable, in describing and analyzing economic change and so contribute to forms of economic decision-making. The data in the national accounts provide aid to decision-making.

78. National accounts are useful in such areas of economic analysis:

- analysis of productivity,
- import demand,
- consumers' demand,
- studies of government spending,
- distribution and redistribution of income fiscal policy,
- saving behaviour
- monetary policy and liquidity preference,
- international finance,
- foreign aid policy,
- balance of trade payments etc.

VIII. PUBLIC DEBT MANAGEMENT[1/]

79. Effective debt management encompasses such issues as administration, operation of an office, communications, information flows and legal authorizations, analysis of credit, balance-of-payments and budget, controlling borrowing and defining strategies, and computerization of information systems, as well as training and retaining people.

80. Debt management has two dimensions: the macro-economic and the micro-administrative. In the former, debt management must be seen as an integral part of a country's overall macro-economic management; in its micro-administrative dimension, it is part of a borader process of public administration and management.

81. As far as external debt is concerned, a government's immediate interest is, of course, its own external liabilities which affects both the budget and foreign exchange reserves. However, government responsibility for foreign exchange reserves and regulations may also imply responsibility for providing foreign exchange to meet the servicing of private sector debt and, eventually, the remittances of profit from direct foreign investment.

1/ See United Nations: Effective debt management. A paper prepared by UNCTAD for Interregional workshop on planning of financial resources for development. Addis Ababa, December 1989.

Debt Management Functions

82. Effective debt management involves primarily seven basic functions: policy regulatory, resourcing, recording, analytical, controlling and operating functions. The first three functions are part of what can be called Executive Debt Management. The other four functions may be considered to be part of Operational Debt Management.

83. Executive Debt Management might be viewed as the establishment of the rules of the game by the highest levels of government. It thus gives direction and organization to the whole which might be called the Debt Management System.

84. Operational Debt Management is the day-to-day management of debt in accordance with executive direction and organization. Operational debt management may in turn be viewed as being composed of passive and active debt management. Although the dividing line is not always clear, the former is meant to involve functions which do not include actions (interactions and transactions) on the debt front, while the latter does. It is obvious that passive management will very much influence active management through the provision of information and analysis, and is of equal importance.

85. The various basic functions of effective debt management can briefly be desceibed as follows.

Executive Management

86. The Policy Function involves the formulation of national debt policies and strategies in coordination with the agencies with prime responsibility for the economic management of a country. Broad policy considerations determine a country's sustainable level of external borrowing. This, in turn, is affected by the flows that the country can use efficiently, and how it can generate the additional foreign exchange earnings needed to meet the service charges without risking external payments difficulties. These ramifications of foreign borrowing mean that external debt policy affects national planning, balance of payments and budget management, and all government agencies that determine the type of investment undertaken in a country. The major output of this function is a well-defined and feasible national indebtedness and external debt strategy.

87. The Regulatory Function of debt management involves the legal, institutional and administrative arrangements for external debt management. It involves the establishment of a well-defined regulatory environment to provide for the well-coordinated, and where necessary centralized, administration of external indebtedness, at the recording, analytical, controlling and operating levels, supported by efficient information flows. The major output of this function is establishment

and continuous review of the administrative and legal framework involving organizational responsibilities, rules and procedures among units involved, legal reporting requirements, etc., i.e. the organization structure.1/ The framework will in large measure define the Degree of Control exercised and the data which can be recorded.

88. The Resourcing Function makes sure that the recording, analytical, controlling and operating functions pertaining to external debt management are performed by qualified staff. It involves recruiting, hiring, motivating, training and retaining staff. At times, it might involve the hiring and supervising of outside consultants to provide for specialized technical expertise in the area of external debt management (i.e. computerization, debt audits, preparation for rescheduling negotiations, etc.). This function must also very broadly be understood as the provision of adequate material resources (office space, communication equipment, etc.). The main output might be termed Staffing and Means.

Operational Management

89. The functions pertaining to operational debt management, particularly, the recording, analytical and controlling functions, can be viewed as being performed on two levels: the Aggregate Level and the Single Transactions (or disaggregated level). The distinction is not always easy to make, but is necessary for a better understanding of debt management.

90. At the executive level, the policy regulatory and resourcing functions will give direction and organization to the debt management system. The macroeconomic environment and the analytical, institutional, administrative, legal and human environment both affect and are affected by these functions. The evolving strategy, structure staffing and means determine the way that debt management is being performed at the operational level.

91. At the operational level, operations, information, analysis and control are the results of the corresponding functions.

92. An effective debt management system is thus constituted of seven building blocks.

1/ Organization structure should be seen as a means to an end, i.e. structure is the means by which strategy is pursued and resources harnessed so that goals, objectives or outputs may be achieved (ends). See E. Kakabase, R. Luchow. S. Vinnicombe, Working in Organizations, Penguin Books, 1988, p. 313

93. While the blocks present the debt management functions at the aggregate level, a closer look at operational debt management is necessary. Indeed, debt orginates at the level of individual transactions. In other words, a country's debt is the aggregation of various operations and the result of various functions performed on a loan-by-loan basis.

94. Various operations are going on at any one time. These operations give rise to various interactions and transactions between the lenders and the borrowers which will need to be monitored and recorded. The operations involved and the actual practice of operational debt management are complex and can not be dealt with in detail here. Some lements can mentioned briefly:

(a) Negotiation involves such elements as:

- establishing a financial framework;
- securing the necessary financial terms;
- ensuring the legal acceptability of the loan contract;
- ensuring the administrative acceptability of the loan contracts (authorization, guarantee, signature).

(b) Utilization of loan proceeds:

- in some cases, the preparation of on-lending contracts;
- in some cases, the provision of local counterpart funds to external financing;
- modifications to loan contracts (i.e. deferring final date for disbursements);
- disbursements and utilisation of funds;
- payments to suppliers;
- follow-up on undisbursed committed amounts.

(c) Debt service involves:

- payments according to schedules;
- updating of schedules and checking;
- follow-up to budget allocation.

95. Borrowing and other agreements or arrangements which imply some kind of debt operation can take many forms, such as bilateral and multilateral concessional loans, export credits, commercial bank loans, debt reorganization, debt conversion, etc. Negotiation, utilization, and service will vary accordingly.

Debt Management Units and Their Related Functions

96. Debt management systems and, in particular, their institutional framework (or which units perform functions related to debt management), differ from country to country and are shaped by historical precedent, constitutional division of responsibility between various tiers of

governments, the internal organization of the government itself, the importance of external debt in the overall economic management, the relative importance of particular types of credits within the overall debt structure, and also the regulatory function of external debt management.

97. Debt management systems differ in the degree of control exercised by the authorities, the strictness of the regulatory environment, the nature of the reporting system instituted for external debt operations, which may be mandatory or voluntary, and which may require prior authorization for incurring external obligations or only expost reporting. They also differ in their treatment of private sector versus public sector loans, as well as their treatment of financial versus non-financial domestic institutions.

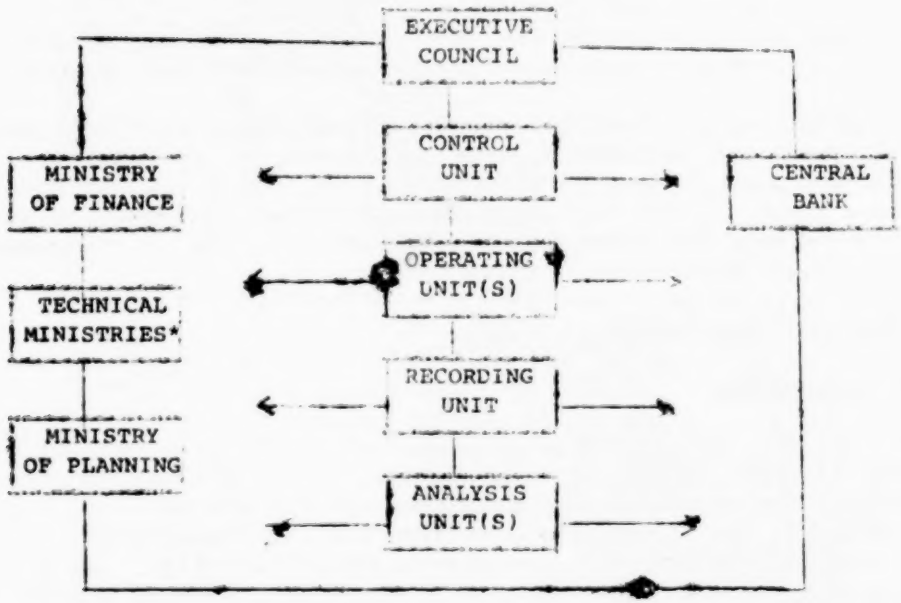
98. When the functions of debt management are all being performed either by the Central Bank, or the Ministry of Finance, or by an autonomous (or semi-autonomous body, which belongs neither to the Central Bank or the Ministry of Finance, the system is said to be centralized.

99. Whether the system is centralized or decentralized, where the various functions of debt management are being performed - in other words, where there is strategy, structure, staffing and means, information, analysis, control and operations - it can be said that the necessary conditions for an effective debt management system exist. But this is not sufficient. It is also required that the debt information management, analysis and decision-making system is integrated into a clearly defined institutional environment. This means that each unit has been assigned functions to perform that do not duplicate efforts and that information, basic and aggregated, is shared consistently amongst them. Obviously, if the different units are located in a single integrated body this goal might be achieved more easily than in a highly decentralized system.

100. Obviously, there is no universally accepted textbook model for debt management units and their related functions. Figure I presents a conceptual model in line with the basic functions of debt management discussed above. For the sake of simplicity, it is assumed that the system deals with public and publicly guaranteed external debt. It is also assumed that a centralized debt management system exists, although in practice the units referred to below are often in fact separated administratively.

Figure 1

INTEGRATED DEBT MANAGEMENT SYSTEM



* including parastatals

101. Figure 1 shows the different units that would need to be established, within a debt management organization structure, to deal with the functions mentioned earlier. Figure 1 does not imply specific location of the different units of the structure, it aims only to highlight them and their respective functions. Nevertheless, in order to ease understanding of the different information-flow problems which need to be overcome, it would be useful to assume here that the whole debt management organization structure is a single integrated body.

102. The top unit is the Executive Council. This is the highest authority regarding external indebtedness. Its members should be at the most senior level: Minister of Finance, Governor of the Central Bank, Minister of Planning, Ministers of Technical Ministries concerned by external indebtedness and, eventually chief executive officers of parastatals that could have access to foreign resources. The Executive Council will exercise the Policy, Regulatory and Resourcing Function as far as the general decisions, guidelines and rules are concerned.

103. As far as the location of the units is concerned, there is a general institutional problem that affects many countries: should particular functions be located in the Ministry of Finance or in the Central Bank (or even elsewhere)? For instance, in the case of the operating/negotiating function of commercial credits, should the Ministry of finance or the Central Bank be in charge of negotiating public sector borrowing? Whatever the choice, should it be done only for the central government, leaving other government agencies and public sector companies to negotiate and manage their own foreign borrowing?

104. Questions will also arise as to the location of the recording unit, the only one which clearly needs centralization into one location.

105. The present paper cannot present any preconceived solution. Each country will have its own system with units both in the Ministry of Finance and the Central Bank performing some or all of the functions. The important issue is that all functions are being performed and that all units co-operate and communicate effectively within an integrated and clearly defined institutional environment.

IX. THE ROLE OF FISCAL POLICY

Economic Structure

106. Since fiscal policy affects economic structure of a country, it is necessary to look briefly at what constitutes an economic structure of a country. Conceptually, all economies can be divided into three major sectors - the 'government; enterprises and households. The government sector discharges the responsibilities of State, including national defence and administration of justice and general apparatus of the State; enterprises produce goods and services for sale to others; and households include individuals and families.

107. The distinction among sectors may be blurred. For example, it is easier to draw a distinction between the government and enterprise sectors in market directed economies than in centrally planned economies. Nevertheless, conceptually the distinction exists based on operational method not on ownership.

Type of Economies

108. For purposes of exposition, one talks of centrally planned and market economies. In a market oriented economy, the allocation of resources is the outcome of millions of independent decisions made by consumers and producers all acting through the medium of markets in which there is order as regards what to produce and what to purchase whether goods or the services of labour. This is done through the price system referred to by Adam Smith in his book "Wealth of Nations" as the "Invisible Hand". The price system works by means of demand and supply.

109. In the centrally planned economy, economic activity guided by prices and income payments are rationing devices even though they may be set by planners instead of by market forces.

Meaning of Fiscal Policy

110. The term fiscal policy does not have precise meaning and there is no clear line to devide fiscal policy from public finance, from monetary policy or from government economic policy. Neither is there agreement on the kind of government actions which may properly be labelled as fiscal policy actions.

111. Historically, the term is derived from the old French word fisc - the money basket or the treasury. The term, therefore, must have been originally synonymous with "public finance" as used in English to embrace the government's revenue, expenditure and debt policies. Defined in operational terms, fiscal policy means the utilization of certain governmental activities and actions in the development and stabilization of the economy. These activities are the tools of fiscal policy-taxation, expenditures and debt management.

The Goals of Fiscal Policy

112. In an advanced industrial economy, the goal of fiscal policy will be defined simply as high level stabilization of economic activity. For developing countries, the goal of fiscal policy includes growth and development.

Fiscal Policy Instruments

113. Fiscal policy decisions are political decisions and they govern the allocation of resources through a budgetary or political process and the mobilization of resources through taxation.

114. The two broad categories of fiscal instruments are government outlays and receipts. Outlays include purchases of goods and services, transfer payments and subsidies and may also include lending and capital subscriptions to enterprises or to lower levels of government. Receipts include taxes, profits from State enterprises, borrowing proceeds.

(a) Budgetary Management - (Expenditures)

115. The government budget is a financial plan which covers the outlays and receipts of the government. These descriptions summarize how fiscal instruments will be used to carry out policy decisions. Government expenditures or outlays are intended to attain macro-economic objectives, growth and development, stability, equitable distribution of income and national economic independence or self-reliance. There is now wide spread appreciation of the fact that the character and volume of government expenditures will affect levels of private income and its distribution and the prices and allocation of resources. Government

expenditures could abolish unemployment and push the economy not only to full employment, beyond full employment to the point where additional expenditures, public and private would be translated into price increases rather than increases in output.

(b) Taxation

116. In the tradition of classical and neoclassical economics taxation was viewed as a means of obtaining revenue for government, as a means of transferring resources from private to the public sector. The more recent approach stresses that taxation does not serve solely to channel funds to finance government outlay. Taxation is also instrumental in controlling the volume of expenditure in the private sector. That taxation affects particular economic activity has long been recognized. Indeed this is inherent in Justice Marshall's famous dictum "The power to tax is the power to destroy". Taxation can also be used to control the level of economic activity. Taxes will affect the level of private income the distribution of that income and the volume of private expenditures. Taxation can therefore be used as an instrumentality to affect the level of prices as well as selectively to affect relative prices and the kinds and varieties of economic activity.

(c) Debt Management

117. The fiscal policy significance of debt management as opposed to narrower financial considerations is now well known. In selling debt obligations a government changes the composition of privately held assets - converts private assets from money to bonds. In some circumstances this conversion will alter the volume of private expenditure. Further more, the bonds that are outstanding are an instrument of economic management. They may be bought and sold by the treasury or the central management. They may be bought and sold by the treasury or the central bank under circumstances which, again, will vary the composition of private assets and rates of income and expenditure.

Characteristic of Fiscal Policy Controls

118. The first characteristic of fiscal policies is that they are aggregative in character, that is, they are intended to influence such magnitudes as the total volume of economic activity, the general level of prices and the general level of prices and the total of consumer spending. The controls utilized by fiscal policy may, therefore, be said to be indirect, in that they do not appear to influence specific transaction within the economy. The kind of controls under fiscal policy are, therefore, indirect in contrast with price regulations which are direct in character and immediately influence particular prices and particular transactions. This distinction is sometimes blurred in application. Indirect controls may turn out to have direct effects. For example, a general increase in personal income taxes designed to restrict the volume of consumer expenditure would be classed as an indirect control of economic activity. Nevertheless such a tax increase will have direct effects in terms of its restriction of particular incomes.

119. A second characteristic of fiscal policies is that they inevitably affect relative shares of national income, the distribution of income between rich and the poor and the distribution of income among farmers, wage earners etc.

120. A third characteristic of fiscal policy controls relates to the government level at which they are formulated and administered. Fiscal policy is the concern of the central government. Local governments do not participate in a positive programme of stabilization.

Workshop Evaluation

121. The workshop was evaluated through the end-of-course questionnaires completed by the participants. The majority of the participants felt that the workshop was useful and relevant and the topics discussed dealt with practical issues which they encounter in their everyday work. With regard to ways and means of improving future workshops on public finance, the participants suggested that selection of participants should not be restricted to only ministry of finance but should extend to all the ministries of the government. This will provide varied exchange of experience. It was further suggested that future workshops should devote more time to group discussions and exercises and that discussion leaders should be less theoretical in presentation of topics.

Closing of the Workshop

122. The workshop was officially closed by Mr. Cyrus sikazine, Deputy Permanent Secretary at Cabinet Office, Zambia. In his closing speech, he drew the attention of the participants to the objective of the workshop and expressed the hope that the topics discussed were found useful. On behalf of the participants, one of the participants thanked the orgenizers of the workshop, NIPA and UNECA.

List of Participants

1.	Mr. F. Kaela	Assistant Commissioner of Taxes
2.	Mr. S.J. MtonGa	Senior Inspector of Taxes
3.	Mr. C.k. Mushabati	Assitant Controller of Internal Audits
4.	Mr. M.C. Lwamba	Acting Assistant Commissioner of Taxes
5.	Mr. S. Kaongolo	Acting Principal Accountant
6.	Mr. B.K.H. Mwiinga	Staff Training Officer
7.	Mr. P.L. Mwenda	Principal Accountant
8.	Mr. S. Kabika	Senior Economist
9.	Mr. M. Luyanga	Administrative Officer
10.	Ms. E.J. Mvula	Principal Accountant

Daily Programme of Work

Public Finance Workshop

Week 1. 1st to 5th April 1991

	8.30 - 10.00	10.00-11.00	11.00 - 12.30		14.30 - 16.00
Monday 1/04/91	Registration		Nature of Public Finance (UNECA)		Nature of Public Finance (UNECA)
Tuesday 2/04/91	Gov't Agencies for Fiscal Administration (Mr. Zulu)		Significance of Public Expenditure (UNECA)		Significance of Public Expenditure (UNECA)
Wednesday 3/04/91	Gov't Agencies Fiscal Administration (Mr. Zulu)		Soruces of Public Income (Taxes) (UNECA)		Free
Thursday 4/04/91	Sources of Public Income (Borrowing) (UNECA)		Principles of Taxation (UNECA)		Principles of Taxation (UNECA)
Friday 5/04/91	Aspects of Tax Administration		National Income Analysis		National Income Analysis

Week 2: 8th to 12th April 1991

	8.30 - 10.00	10.00-11.00	11.00 - 12.30		14.30 - 16.00
Monday 8/04/91	Group Discussion on 1 on GRZ Public Expenditure	M	Group Discussion Continued	H	Group Discussion Report 1 & 2
Tuesday 9/04/91	2 Sign. of GRZ Tax (Mr. Sakala)	A	Monetary Policy (Mr. Sakala)	O	Planning of National Debts (UNECA)
Wednesday 10/4/91	The Role of Fiscal Policy:Taxation (UNECA)	R	The Role of Fiscal Policy (Budget) (UNECA)	N	The Role of Fiscal Policy (Budget) (UNECA)
Thursday 11/04/91	General Discussion (Fiscal, Expenditure etc. Summary (UNECA)	K	General Discussion (Summary) (UNECA)	D	Evaluation
Friday 12/04/91	Free	E	Free	L	Closure of Workshop